

Office of City Auditor

**DEPARTMENT OF DESIGN,
CONSTRUCTION AND LAND USE
TRACKING FINANCIAL MANAGEMENT IMPROVEMENTS
OCTOBER 1, 1999 THROUGH JULY 30, 2000**

SEPTEMBER 12, 2000

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City of Seattle

Office of City Auditor
Susan Cohen, City Auditor

September 12, 2000

The Honorable Paul Schell
Seattle City Councilmembers
City of Seattle
Seattle, Washington 98104-1876

Dear Mayor Schell and City Councilmembers:

In November, 1999, the Office of City Auditor issued a Report titled "Department of Design Construction and Land Use: Tracking Financial Management Improvements". The Report tracked the financial management changes at DCLU from January 1, 1997 through September 30, 1999. The purpose of the attached Report is to follow up on DCLU's progress on eight recommendations from the 1999 Report and to detail financial management improvements from October 1, 1999 through July 30, 2000.

If you have any questions regarding this report or would like additional information, please call me at 233-1093.

Sincerely,

Susan Cohen
City Auditor

Attachment



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BACKGROUND AND REVIEW SCOPE

The Office of City Auditor issued a report, “Department of Design, Construction and Land Use: Tracking Financial Management Improvements”, on November 9, 1999. That report tracked the financial management changes at DCLU from January 1, 1997 through September 30, 1999. The purpose of this report is to follow up on recommendations from the 1999 report and describe financial management improvements from October 1, 1999 through July 30, 2000.

Our primary objective was to review DCLU’s progress on eight recommendations from the 1999 report. Our methodology included: reviewing new systems and support documentation, interviewing DCLU personnel and consultants, and distributing employee questionnaires.

CONCLUSION

In the last ten months, DCLU made significant progress toward implementing sound financial management practices. Specifically, the Department has:

- Formally documented deferred revenue estimating policies, including refining the estimating methodology.
- Eliminated revenue sources that did not have clear relationships to fees or funding.
- Deleted programs that were not useful in managing the Department.
- Developed an overhead allocation methodology based on labor costs.
- Formalized interest allocation procedures.
- Hired an experienced Chief Financial Officer (who is credited with the leadership for the Department’s improved financial management).
- Reduced the number of program directors reporting directly to the Department Director from five to two.
- Developed a designation policy to set aside revenues for staffing during an economic downturn (including pay out of accrued leave), technology replacement/enhancement, and strategic planning.
- Refined cost accounting practices to include expenditure accruals.

An additional benefit of DCLU’s work on financial management practices is that the department is fully prepared to implement accrual-based accounting by 2001, as required by the Governmental Accounting Standards Board (GASB) Statement Number 34.

In the next year, DCLU is committed to further improving financial management by:

- Continuing to refine the cost accounting system by combining minor revenue sources and reducing the number of programs within revenue sources.
- Providing employees with annual timekeeping training.
- Seeking approval for adequate expenditure authority through an ordinance authorizing the expenditure of excess revenues when revenues exceed budget projections.

IMPLEMENTATION OF RECOMMENDATIONS

The 1999 report outlined eight general recommendations related to DCLU's financial management. Three recommendations were related to the continued improvement process and five were longer term issues to consider in 2000 and beyond. Mainly due to the quick recruitment and employment of a competent CFO (Report Topic 5), DCLU was able to address most of the recommendations in the last ten months.

The recommendations from the original report are listed below. Each recommendation is followed by a description of DCLU's efforts to implement it, and by our assessment of DCLU's implementation progress as follows:

Fully Implemented – Five recommendations are fully implemented meeting the intent of the recommendation.

Implemented – Two recommendations are implemented but need minor adjustments.

Not Implemented – One recommendation has not been implemented.

Report Topic 1: Revenues Are Now Booked To The Proper Accounting Period

Recommendation for Continued Improvement: Deferred revenue estimating policies should be formally documented. The written policies should describe the exact methodology for biannually calculating deferred revenue, and should state who is responsible for the calculations. The policies should also include a provision for an annual review and approval process by the Department Chief Financial Officer (CFO) and the Director of DCLU.

Fully Implemented: Based on a review of the 1999 and mid-year 2000 deferred revenue estimates and associated documentation, the deferral calculations were appropriate and the support adequate. The deferral was estimated in accordance with Department policy and reviewed and approved by the CFO and the Director.

Report Topic 2: Labor Timekeeping System Has Been Implemented

Recommendation: Further define cost accounting systems that strengthen the relationship between input to the timekeeping system and costs assigned to specific revenue sources. Specifically:

- 1) Discontinue dividing revenue sources into revenue types;
- 2) Refine work activities based on correlating revenue sources;
- 3) Minimize activities supported by more than one revenue source;
- 4) Eliminate gray areas in timekeeping instructions; and
- 5) Make it simple for employees to charge their time to correct codes.

Implemented: DCLU developed a new "expenditure to revenue" model, greatly improving the relationship between revenue sources and expenditures. The labor costs used in the model are still collected at too low a level creating some confusion for employees. The labor charging levels need to be reduced or, if that is not practical, extensive training should be implemented on an annual basis.

Report Topic 3: Methodology for Allocating Administrative Costs Has Been Developed

Recommendation: Refine general and administrative cost allocations. Specifically:

- 1) Define general and administrative versus support costs;
- 2) Develop an allocation methodology based on labor or total expenditures for general and administrative costs;
- 3) Allocate support costs to revenue sources based on actual costs;
- 4) Use prior actual data for budgeting purposes only; and
- 5) Write a formal cost allocation policy that includes clear definitions, allocation methodologies, and monitoring procedures.

Fully Implemented: Labor costs that cannot be clearly identified to a revenue source are now charged to general and administrative (overhead). Overhead is allocated based on labor dollars. This is a simple and logical allocation policy. A formal allocation policy is not needed.

Report Topic 4: Interest Income Allocations are Documented and Reasonable

Recommendation: Policies for allocating interest income should be formalized through written procedures. The procedures should include timing, methodology, and responsibility.

Fully Implemented: A formal interest income (and interest expense) policy has been written. Based on our review of the 1999 allocation, the policy was followed. The policy allocates interest income (or expenses) based on quarterly average cash balances for each revenue source.

Report Topic 5: DCLU Needs to Hire a Chief Operating Officer (COO) and a Chief Financial Officer (CFO) to Properly Influence and Develop Sound Financial Policies

Recommendation: Hire a Chief Operating Officer and a Chief Financial Officer

Fully Implemented: DCLU hired a CFO in December 1999. He has made significant progress on developing sound financial policies. Instead of hiring a COO, DCLU elected to replace the program director level of the organization (5 direct reports) with one deputy for external matters and one for internal. This change satisfies the intent of the recommendation and Department personnel believe this structure will be effective.

Report Topic 6: Reserves and Designations

Recommendations: DCLU management needs to differentiate between designations and reserves, and to determine how designations and reserves correlate with City and State regulations.

Fully Implemented: DCLU has determined that its revenue set-asides are designations. The set-asides will be estimated annually in accordance with stated policy for all revenue sources (including the General Fund). The spend-down of the designations may or may not follow the exact designation category. DCLU's policy on set-asides is GASB-compliant and correlates with City and State regulations.

Report Topic 7: DCLU Has Several Options for Allocating a Portion of Fee Revenues for Staffing Stability and Capital Improvements

Recommendations: Develop a GASB-compliant financial accounting system and equitable cost accounting methodology to fund staffing stability and capital improvements in a logical consistent manner. Specifically:

- 1) Determine what type of accounting best fits DCLU;
- 2) Understand accounting requirements and options for funding staffing stability or economic downturn by researching GASB and Government GAAP (Generally Accepted Accounting Principles); and
- 3) Develop written policies to include financial accounting procedures, reconciliation between financial and cost reporting, and responsibilities for implementation.

Implemented: DCLU is preparing to follow accrual based accounting (Enterprise Fund) by 2001. They have also determined that staffing stability and capital improvements are funded through designations. Designation amounts are consistent percentages of revenue dollars across all sources (including the General Fund). Written policies are still needed especially in the areas of reconciling financial and cost accounting data.

Report Topic 8: DCLU's Budget Process Needs Major Rethinking

Recommendation: DCLU should request assistance from the City Attorney to draft an ordinance similar to that of Seattle Center. The ordinance should authorize the expenditure of revenues, beyond those estimated in the adopted budget, specifically for those offsetting the cost of earning the revenue. The ordinance could also reduce expenditure authority if revenues are lower than estimated.

Not Implemented: DCLU has not received support for the recommended ordinance. This is an important element for DCLU's financial health, now and in the future. Currently, permit revenues in excess of budget projections can only be used for processing and administering the issuance of permits associated with those revenues. By not allowing DCLU expenditure authority up to revenue levels (less set-asides), the city is risking an inferior permitting process, either in the health and safety of its citizens or in processing time.



City of Seattle

Paul Schell, Mayor

Department of Design, Construction and Land Use

R. F. Krochalis, Director

August 30, 2000

Susan Cohen
City Auditor
1100 Municipal Building
600 Fourth Avenue
Seattle, WA 98104-1876

Dear Ms. Cohen:

Thank you for the opportunity to comment on your final draft report, "Department of Design, Construction and Land Use Tracking Financial Management Improvements October 1, 1999 through July 30, 2000." I am pleased at the progress DCLU has made during the period of your audit, and I want to emphasize our commitment to fully implementing the remaining recommendations.

Continued Improvements

Labor timekeeping system: The department continues to review the number of activities that employees need to use to accurately charge their time, and we expect to make additional simplifications for 2001-02. We will also schedule training for staff in the timekeeping system as the 2001-02 coding is implemented.

Reconciliation of financial and cost accounting data: The department intends to use Summit to the maximum extent possible to satisfy both our financial and our cost accounting requirements. Our intent is to minimize or eliminate the need for reconciliations by using distinct reports from the same database to provide the budgetary, GAAP based financial, and cost accounting information we need. We have already begun reviewing our coding structures in Summit to accomplish this for 2001.

Flexible expenditure authority: The department is working with CBO to devise a process that will provide additional spending authority promptly when identified conditions occur that demonstrate the demand for additional services and the resources to support the additional spending. Our preference would be to gain support from City Council during their budget deliberations this fall.

I look forward to continued interactions with you and your staff as the department addresses your recommendations and other improvements in DCLU's financial management systems.

Sincerely,

Rick Krochalis
Director



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